New Adventures in Fee Collection:
Drafting and Enforcing Attorneys' Fee Clauses After *Travelers*

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For decades, courts in the Ninth Circuit have barred any recovery of attorneys' fees incurred while litigating "issues" of federal bankruptcy law on the grounds that such allowance would be inconsistent with bankruptcy policy, notwithstanding the existence of an otherwise enforceable (and applicable) attorneys' fee clause in the underlying contract at issue. Known as the "*Fobian* Rule," this approach has been consistently followed since its articulation in *Fobian v. W. Farm Credit Bank (In re Fobian)* (9th Cir. 1991) 951 F.2d 1149. (E.g. *Am. Express Travel Related Servs. Co. v. Hashemi (In re Hashemi)* (9th Cir. 1996) 104 F.3d 1122, 1126-27; *In re LCO Enterprises, Inc*. (B.A.P. 9th Cir. 1995) 180 B.R. 567, 569; *Hassen Imports P'ship v. KWP Fin. VI (In re Hassen Imports P'ship)* (B.A.P. 9th Cir. 2000) 256 B.R. 916, 920-23.)

In *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co*. (2007) 127 S.Ct. 1199, the United States Supreme Court struck down the *Fobian* rule but offered little guidance as to allowance of attorneys' fees in bankruptcy cases. This article analyzes the implications of *Travelers* for parties drafting attorneys' fees clauses in California contracts, offers sample attorneys' fees provisions, and discusses drafting issues.

I. Dissecting *Travelers*

The heart of the Supreme Court's ruling in *Travelers*, was its rejection of *Fobian's* distinction between litigating bankruptcy and non-bankruptcy "issues" as a basis for disallowing attorneys' fees sought under the terms of a pre-petition state law contract. The Supreme Court held that this distinction had no basis in the Bankruptcy Code. The Court determined that in the absence of an express provision in the Bankruptcy Code requiring disallowance, "[a] claim for such fees would be allowed in bankruptcy to the extent enforceable under state law." (*Travelers, supra*, 127 S.Ct. at p. 1206 (citing 4 *Collier on Bankruptcy* ¶506.04[3][a], at 506-118 (rev. 15th ed. 2006).) Because the *Fobian* rule was the sole basis for the Ninth Circuit's ruling, the Supreme Court remanded the case to the Ninth Circuit.

The most problematic aspect of the decision was the Supreme Court's refusal to provide any guidance on the ultimate question: whether the Bankruptcy Code—in and of itself—required the wholesale disallowance of claims for post-petition attorneys' fees that were otherwise compensable under the terms of a valid and enforceable pre-petition contract: "[W]e express no opinion with regard to whether, following the demise of the *Fobian* rule, other principles of bankruptcy law might provide an independent basis for disallowing Travelers' claim for attorneys' fees." (*Travelers, supra*, 127 S.Ct. at p. 1208.)

This sends the attorneys' fees issue back to the lower courts for further case law development.

Moreover, the court's detailed discussion of claims allowance under section 502 has produced divergent interpretations. Some commentators have argued that the Court's reasoning and construction of section 502 leads to the conclusion that such fees are recoverable as a claim in bankruptcy, while others have argued that inferences drawn from section 506(b), and the court's reasoning in both *Timbers of Inwood Forest Assocs., Ltd.* (1988) 484 U.S. 365 and *Randolph and Randolph v. Scruggs* (1903) 190 U.S. 533, require the disallowance of fee claims of unsecured creditors. (See, e.g., Mark Scarberry, *Interpreting Bankruptcy Code Sections 502 and 506: Post-Petition Attorneys' Fees in a Post-*Travelers *World* (Forthcoming Winter 2007) 15 Am. Bankr. Inst. L.Rev.; Mertens, *Travelers and the Implications of the Allowability of Unsecured Creditors' Claims for Post-Petition Attorneys' Fees Against the Bankruptcy Estate* (Spring 2007) 81 Am. Bankr. L.J. 123; Heuer, *Qmect Inc.: Picking Up Where Travelers Left Off* (July/August 2007) 26 Am. Bankr. Inst.J. 32; R. Brubaker, *Allowance of Attorney's Fees to an Unsecured Creditor: The Supreme Court Has Spoken (and Said Nothing)* (May 2007) 27 No. 5 Bankruptcy Law Letter 1; Elmquist, *Can an Unsecured Creditor Recover Post-Petition Attorneys Fees? The Question Not Answered in Travelers* (May 2007) 25 Am. Bankr. Inst.J. 10.) This debate relates back to prior case law on the section 506(b) issue that held amounts in excess of what can be allowed as a secured claim under section 506(b) are still recoverable as unsecured claims; implicit in such holdings is the conclusion that all post-petition attorneys' fee claims are "claims" subject to § 502 allowance. (See *Welzel v. Advocate Realty Invs., LLC (In re Welzel)* (11th Cir. 2001) 275 F.3d 1308 (bifurcating claims under § 506(b).)

Since *Travelers,* at least one bankruptcy court in the Ninth Circuit has allowed the recovery of post-petition attorneys' fees, expressly rejecting the § 506(b) argument for disallowing attorneys' fees of an unsecured creditor. (*In re QMECT, Inc.* (Bankr. N.D. Cal. 2007) 368 B.R. 882.) This is consistent with some prior Ninth Circuit authority, and authority from other circuit courts of appeals. For example, *In re 268 Ltd.* (9th Cir. 1986) 789 F.2d 674, 678, the court held that by allowing "reasonable fees" as part of secured claims, section 506(b) "preempts state law governing the availability of attorney's fees as part of a secured claim" by limiting recovery to only such fees as are "reasonable." (*Id.* at p. 678.) However, the court also stated in dicta that the limitation on the secured portion "does not preclude [the creditor] from seeking the contractual fees in excess of the [allowed secured portion] as an unsecured claim" just as other unsecured creditors may under section 502(b)(1). (*Id.* at p. 678.) Whether the post-*Travelers* analysis of *Qmect* will be followed remains to be seen. At least one post-*Travelers* case has held that unsecured creditors are not entitled to recover contractually-based attorneys' fees incurred postpetition pursuant to section 506(b) and the Supreme Court's decision in *Timbers of Inwood Forest Assocs*., finding that

> [t]he majority of courts that have considered whether an unsecured creditor is entitled to recover attorneys' fees and other post-petition costs and charges as part of its unsecured claim have concluded that unsecured and undersecured creditors are not entitled to recover post-petition

> attorneys' fees and similar costs." (*In re Electric Machinery Enterprises, Inc.* (Bankr. M.D. Fla. 2007) 371 B.R. 549, 550 (citations omitted).)

With *Fobian* overruled, recoveries of post-petition attorneys' fees are now at least *possible* in the Ninth Circuit. Creditors should review their contractual agreements in order to have a complete understanding of their potential claims in the event that they are faced with the bankruptcy of a contracted counterparty. More importantly, contracting parties should consider *Travelers'* implications in drafting attorneys' fees clauses in the future.

II. Recovery of Attorneys' Fees Under California Law

Travelers reiterated the principle that the allowability of attorneys' fees claims based upon contractual clauses depends first and foremost upon their enforceability under applicable state law. Looking to California law, each party to a litigation or dispute generally pays its own attorneys' fees except where a statute or contract provides otherwise. (Code Civ. Proc., § 1021.) This is consistent with the "American Rule" regarding the recovery of attorneys' fees. (See *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y* (1975) 421 U.S. 240.) Where a contract provides for the recovery of fees, California courts will enforce the contract term. (See, e.g., *Guild Wineries and Distilleries v. Land Dynamics, Etc*. (1980) 103 Cal.App.3d 966, 979.

The California Reciprocity Rule

However, even if a contractual attorneys' fees clause only grants recovery by one party, Civil Code section 1717, subdivision (a) automatically renders all contractual attorneys' fees clauses reciprocal in favor of the prevailing party, regardless of the terms of the contract and regardless of the parties' intent:

> In any action on a contract, where the contract specifically provides that attorneys' fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, *whether he or she is the party specified in the contract or not*, shall be entitled to reasonable attorneys' fees in addition to other costs.

(Civ. Code, § 1717, subdivision (a) (emphasis supplied).) This statute operates to insure fairness where bargaining positions may have been unequal. Many states, including New York, have no statutory analog, while others have similar statutes with different terms.

The Broad Reach of the Reciprocity Rule

Consistent with section 1717, subdivision (a)'s remedial purpose, the reciprocity it offers has been liberally construed. It has been held to apply:

(1) to all actions that "involve" a contract. *Dell Merk, Inc. v. Franzia* (2005) 132 Cal.App.4th 443, 455 ("As long as the action *'involve[s]'* a contract it

is ‘on [the] contract’ within the meaning of section 1717.”) (emphasis supplied);

(2) to the entire contract, not just certain aspects of it. Civ. Code, § 1717, subd, (a) (“Where a contract provides for attorneys’ fees . . . that provision shall be construed as applying to the *entire contract*. . . .”) (emphasis supplied);

(3) to nonsignatories to the contract. *Wilson's Heating and Air Conditioning v. Wells Fargo Bank* (1988) 202 Cal.App.3d 1326, (section 1717 is sufficiently broad that it may encompass *non-signatories* to a contract); see also *Reynolds Metals Co. v. Alperson* (1979) 25 Cal. 3d 124, 128, (“Its purposes require section 1717 be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney’s fees should he prevail in enforcing the contractual obligation against the defendant.”); *Dell Merk, supra,* 132 Cal.App.4th at p. 455 (general contractor who was sued by a bank to recover progress payments was entitled to attorneys’ fees under the loan agreement between the bank and the borrower/property owner); but see *Sherwood Partners, Inc. v. EOP-Marina Business Center, LLP* (2007)62 Cal.Rptr.3d 896 (assignee for benefit of creditors of tenant not liable for payment of landlord’s attorneys’ fees pursuant to lease provision in connection with litigation involving recovery of security deposit in which landlord prevailed, because assignee did not assume contractual liabilities in lease, including attorneys’ fee provision);

(4) in federal court actions involving California state law. *In re Baroff* (9th Cir. 1997) 105 F.3d 439, 442-43 (section 1717 applies to “any action on the contract” under California law, whether brought in state or federal courts); *In re Sparkman* (9th Cir. 1983) 703 F.2d. 1097, 1099 (section 1717 applies in federal cases involving California contracts);

(5) where the underlying contract has been found unenforceable. *MBNA Am. Bank, N.A. v. Gorman* (2006) 147 Cal.App.4th 1, (awarding fees to a credit card holder for successful opposition to bank’s petition to confirm award under unenforceable mandatory arbitration clause; “[A] party is entitled to attorney fees under section 1717 ‘even when the party prevails on grounds the contract is inapplicable, invalid, unenforceable, or nonexistent, if the other party would have been entitled to attorneys’ fees had it prevailed.’ [citations omitted]”); see also *Care Constr. Inc. v. Century Convalescent Ctr., Inc.* (1976) 54 Cal.App.3d 701, 707, (awarding fees to defendant who successfully defended on theory that there was no valid or enforceable lease, because the lessor would have been entitled to fees had it prevailed); and

(6) to actions where a contract remedy was elected, even though a tort remedy was pled in the alternative. *Star Pac. Invs., Inc. v. Oro Hills Ranch, Inc.* (1981) 121 Cal.App.3d. 447, 461 (proceeding was "an action on the contract" where party claimed fraudulent inducement and sought rescission, as opposed to a tort remedy).

Limitations on Reciprocity

Despite section 1717's remarkably broad scope, it does have some limits. For example, the action must be "on a contract;" "pure" tort claims are not covered. (Civ. Code, § 1717, subd. (a).) (See *Gil v. Mansano* (2004) 121 Cal.App.4th 739, 744 (the contract clause limited recovery of fees to "actions to enforce" the contract, and thus did not cover related tort claims; this "narrow" clause was contrasted with broader attorneys' fees provisions covering "any dispute under the agreement" that would have encompassed contractual defenses to fraud, breach of fiduciary duty and other tort claims).) Nor do general indemnification clauses qualify as "attorneys' fees clauses" that qualify for reciprocity. (See *Campbell v. Scripps Bank* (2000) 78 Cal.App.4th 1328, 1336 (indemnification clause does not give rise to § 1717 claim for attorney fees).) Finally, section 1717, subdivision (a) will not override an express, substantive limitation on the scope of recovery. For example, if an attorneys' fees clause applies only if a lawsuit is filed, that limitation will be given effect. (See *Gil*, *supra*, 121 Cal.App.4th at p. 743 (denying fees, holding: "The language 'brings an action to enforce the contract' is quite narrow.").)

Determining the "Prevailing Party"

The meaning of "prevailing party" is central to a section 1717, subdivision (a) analysis. Subsection (b) provides: "The party prevailing on the contract shall be the party who recovered a greater relief in the action on the contract." (Civ. Code, § 1717, subd. (b)(1).) Trial courts have wide discretion in determining who is the prevailing party, regardless of which party received the greater amount of damages. Where litigation is concerned, "[t]he court may also determine that there is no party prevailing on the contract for the purposes of this section." (Civ. Code, § 1717, subd. (b)(1).)

Complex litigation often leads to decisions granting partial relief to both sides, making it difficult to determine which party has prevailed within the meaning of section 1717, subdivision (a). The courts have generally taken into account both the issues upon which each party could be said to have prevailed and any offsetting awards. The net, rather than gross, recovery on the underlying claims is usually the basis for determination of the amount of attorneys' fees. (See 7 Witkin, California Procedure § 160 (4th ed. 2007); *Indep. Iron Works v. Tulare* (1962) 207 Cal.App.2d 164 (affirming small award where much of the fees requested related to the unsuccessful defense of a cross-claim; court could consider all circumstances, including entry of partial judgments on both complaint and cross-complaint, and net amount of recovery).) Even if one side received a larger monetary recovery, that fact may not be determinative, depending upon which party prevailed on the central issues of liability. (*Sears v. Baccaglio* (1998) 60 Cal.App.4th 1136, 1151 (where guarantor/plaintiff failed to invalidate guarantee but was

awarded partial refund of overpayments, the defendant/cross-plaintiff nevertheless prevailed on underlying issue of liability and was entitled to attorneys' fees despite being the party making the monetary payment).)

In addition, no final judgment is required for there to be an award of fees. (Civ. Code, § 1717, subd. (b)(1).) However, "[w]here an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party for the purposes of this section." (Civ. Code, § 1717, subd. (b)(2).) This restriction encourages voluntary dismissal of pointless litigation without automatically incurring demands for attorneys' fees. A recurring issue is thus how late in the process can a party voluntarily dismiss without being liable for fees. (See *In re Arrow Transp. Co. of Del.* (Bankr. D.Ore. 1998) 224 B.R. 457 (debtor entitled to fees even though claimants withdrew claim immediately before motion for summary judgment was filed, because debtor incurred substantial fees regarding the motion prior to withdrawal of claim).)

III. Drafting Attorneys' Fee Clauses in Light of *Travelers*

Bankruptcy cases involve many discrete disputes among and between the debtor and creditors, not just one dispute that can be resolved by one judgment with one prevailing party. Parties to California contracts must be mindful that any attorneys' fees clause will be given reciprocal effect. This means that, in the wake of *Travelers'* expansion of enforceability of such clauses in bankruptcy cases, putative creditors may find themselves paying for debtors' attorneys' fees in unexpected circumstances if the applicable clause is overbroad.

Direct Contract Disputes

Claims litigation: Even under the *Fobian* doctrine, some kinds of post-petition attorneys' fees have generally been allowable in bankruptcy cases. Attorneys' fees arising out of contract-based claims objections have generally been recoverable by the "prevailing party," where the terms of the contract are directly at issue. (E.g., *In re Arrow Transp. Co. of Del.* (Bankr. D.Ore. 1998) 224 B.R. 457 (debtor entitled to prevailing party attorneys' fees for successful objection to proof of claim).)

However, like other litigation, claim objections may not produce a clear-cut winner. They frequently are not an "all or none" proposition; to the contrary, it is common for partial relief (at times, in favor of both parties) to be granted. Courts struggle with application of the "prevailing party" doctrine where only part of a claim is disallowed. (See *In re McGaw Prop. Mgmt, Inc.* (Bankr. C.D. Cal. 1991) 133 B.R. 227 (in a split decision regarding an objection to secured claim, court determined that $25,000 and not the full amount of the claim was really at issue, limiting the secured creditor's contractual attorneys' fees to 50% of $2,000 it won, and limiting the debtor's "prevailing party" attorneys' fees to 50% of the $15,000 it won).)

It is an open question whether claims litigation regarding a statutory objection, such as the "landlord cap" of section 502(b)(6), is an "action on the contract" although it would certainly involve the contract. *Travelers* arguably rejects such a distinction by

rejecting the *Fobian* rule. But what if the procedural context is the landlord's motion to dismiss the case as a bad faith filing solely for the purpose of invoking the limitation on damages for that particular lease? Interpretation or application of the terms of the lease would not be at issue, but rather the debtor's intent in filing the bankruptcy petition. If the attorneys' fees clause provided for fees incurred in "protecting rights" under the lease, then maybe so. If the clause applies only to "actions to enforce" the lease, perhaps not.

Section 365 litigation: Even under *Fobian*, attorneys' fees have generally been awarded to prevailing parties in litigation involving Bankruptcy Code section 365's provisions governing assumption and rejection of executory contracts. For example, fees are allowable for litigation over the cure requirements for assumption of an executory contract because the statute enforces contractual rights regarding cure of defaults and compensation for pecuniary losses pursuant to the contract. (*In re Richard Bullock* (B.A.P. 9th Cir. 1982) 17 B.R. 438 (lessor's attorneys' fees from adversary proceeding should be paid as part of curing debtor's default on lease and in compensation for lessor's actual pecuniary loss); *In re Shangra-La, Inc.* (4th Cir. 1999) 167 F.3d 843 (default compensation required to be paid to lessor under section 365(b)(1)(B) in connection with assumption of lease includes amounts provided for under contractual attorneys' fees provision).) Where a debtor's contract counter-party successfully blocks assumption of a contract, fees have also been awarded to the contract counter-party who is seeking to enforce its contract rights. (*In re Jet I Ctr., Inc.* (Bankr. M.D. Fla. 2006) 344 B.R. 168 (lessor entitled to attorneys' fee award as prevailing party for successfully opposing assumption of the lease on the grounds that it had been terminated pre-petition).)

Indirect Litigation Regarding the Contract

Dischargeability litigation: Courts outside the Ninth Circuit have generally considered actions to determine dischargeability of contract debts under section 523 of the Code to constitute actions seeking to enforce and therefore arising under the contract, thus allowing *creditors* to recover their attorneys' fees. (See 11 U.S.C. § 523(d); *Martin v. Bank of Germantown (In re Martin)* (6th Cir. 1985) 761 F.2d 1163 (in section 523(a)(2) action, creditor was contractually entitled to attorneys' fees under state law for enforcement of promissory note; although section 523 eliminated prior statutory basis for prevailing creditors to receive attorneys' fees in nondischargeability litigation, it did not eliminate any state law basis for such fees); *In re Mayer* (7th Cir. 1995) 51 F.3d 670, *cert. den.* 516 U.S. 1008 (1995) (contractual attorneys' fees clause may be enforced by prevailing creditor in dischargeability action if provision is valid under state law); *Alport v. Ritter (In re Alport)* (8th Cir. 1998) 144 F.3d 1163 (creditor was entitled to attorneys' fees in section 523(a)(2) action because contract provided for recovery of reasonable attorneys' fees when prevailing "in any matter" under the contract); *TranSouth Fin. Corp. v. Johnson* (11th Cir. 1991) 931 F.2d 1505 (although section 523 does not provide a statutory basis for creditors' fees, creditor was contractually entitled to attorneys' fees incurred in collecting on note after default).)

In contrast, the pre-*Travelers* Ninth Circuit allowed creditors only very limited recovery of fees, and then only fees relating to contract issues. Thus in *In re Baroff* (9th Cir. 1997) 105 F.3d 439, a creditor that prevailed upon a "fraudulent inducement" claim

under section 523 was allowed recovery of all reasonable fees because the debtor's unsuccessful defense was premised upon the enforceability of a settlement agreement that contained the attorneys' fees clause at issue. *Fobian* was distinguished on the ground that the fees requested there did not relate to the underlying validity of the claim. More commonly, however, the Ninth Circuit has applied *Fobian* to bar recoveries of fees related to issues of fraud, misrepresentation and other grounds for nondischargeability on the theory that dischargeability implicates bankruptcy, not state law, issues. (See, e.g., *Renfrow v. Draper* (9th Cir. 2000) 232 F.3d 688, 692-95 (allowing fees for state law contract enforceability issues, but disallowing fees for issues involved in determination of dischargeability).)

Section 523 is silent as to the recovery of fees by creditors. With respect to debtors, however, Bankruptcy Code section 523(d) provides specific requirements that must be met by a debtor in order to recover their fees in the consumer debt context. The more restrictive federal standard contained in section 523(d) has been held to override state reciprocity laws. (See *In re Osborne* (Bankr. C.D. Cal. 2000) 257 B.R. 28, 31-2 (section 523(d) preempts reciprocity statute where debtor seeks to recover as "prevailing party."); see also *In re Sheridan* (7th Cir. 1997) 105 F.3d 1164, 1167 (debtor was not entitled to attorneys' fees for successful defense of section 523(a)(2) action because he did not qualify for fees under section 523(d), holding that "this federal action does not qualify as one 'with respect to the contract' under the Florida [reciprocity] statute" and thus state law cannot prevail over express federal statutory standards). (Note: a sharp dissent criticizes divergence from state reciprocity law).

Avoidance Actions: Pre-*Travelers*, the Ninth Circuit applied *Fobian* and barred recovery of fees for preference and fraudulent transfer avoidance litigation on the ground that it was unique to bankruptcy. (*In re LCO Enters., Inc* (B.A.P. 9th Cir. 1995) 180 B.R. 567, 570-71 (denying attorneys' fees to successful preference defendant who had defended on the ground that the contract was assumed and thus all defaults would have had to be cured in any event; holding, "This litigation was based wholly in bankruptcy law," and "was not an action under the contract which gives effect to the attorneys' fees clause in the contract.").) This result may have to be reconsidered under *Travelers*, as a result of the demise of the *Fobian* rule.

Non-Contract Case Administration Litigation

Travelers itself involved (among other things) fees incurred in monitoring the chapter 11 case, participating in the plan and disclosure statement process and other "administration of the case" matters. Its disposition on remand may help clarify the allowability of fees incurred in such generalized activities that are not specific as to the contract at issue. Little case law addresses contractual claims to attorneys' fees for such activities as case monitoring and hearing attendance, motions for relief from stay, cash collateral motions, objections to plans and disclosure statements, and post-confirmation disputes. Although recovery of fees is no longer barred by the *Fobian* Rule, these kinds of activities may not fall within the defined limits of particular attorneys' fees clauses. Nor may they qualify as "actions on the contract" for purposes of California Civil Code section 1717 reciprocity. Even if they pass muster under both of these elements for

recovery, courts may have difficulty deciding who is the prevailing party, where many such objections and motions are made for strategic purposes and may yield the leverage sought, even if the immediate motion is denied. For example, in *In re Hoopai* (B.A.P. 9th Cir. 2007) 369 B.R. 506, the BAP reversed and remanded an award of fees to an oversecured creditor, holding that the debtor was actually the prevailing party on the motion for relief from stay, motion to sell real property, and plan confirmation issues where "[n]either the validity of Countrywide's liens nor the prospect for full payment were ever in question," and the chapter 13 plan was ultimately confirmed over the secured creditor's objections.

Set-off Issues:

In addition to seeking a cash recovery for their attorneys' fees, parties may seek to use attorneys' fees recoveries as a setoff. Bankruptcy Code section 553 generally "preserves" any right to setoff existing under state law. To effectuate a setoff in the post-petition period, a creditor must obtain relief from the automatic stay under Bankruptcy Code section 362, but a debtor or trustee generally does not. If the debtor or trustee obtains an award of post-petition attorneys' fees under a contract and/or state reciprocity statute, must the creditor separately pay such the award to the estate, or can it set them off against prepetition debt owed by the debtor to the creditor? Setoff is generally a better result for a creditor because the creditor gets "dollar for dollar" credit in a setoff situation, as compared with being paid in typically discounted "bankruptcy dollars" on any claims it pursues.

Even when incurred in the post-petition period, contract-based attorneys' fee claims—when made by creditors—are generally considered pre-petition claims (because they arise out of a pre-petition contract). (*In re Abercrombie* (9th Cir. 1998) 139 F.3d 755, 758 (denying creditor's claim to allow post-petition fees as administrative priority claim).) Will the same kinds of recoveries—but in favor of debtors—also be considered pre-petition in nature, such that setoff may be available, or will they be considered post-petition, such that the "mutuality of debts" requirement will be destroyed such that setoff generally will not be available? In any event, it must be remembered that setoff under "[s]ection 553 . . . is permissive, not mandatory." It is an "equitable remedy" that the court is free to deny. (*In re Cascade Roads, Inc.* (9th Cir. 1994) 34 F.3d. 756, 762-3; see *Newbery Corp. v. Fireman's Fund Ins. Co. (In re Newbury Corp.)* (9th Cir. 1996) 95 F.3d 1392, 1398-99 (discussing requirement of "mutuality of debts" and stating that "[T]he mutuality requirement in bankruptcy should be strictly construed . . . .").)

Tailoring the Language of Attorneys' Fees Clauses:

Attorneys' fees clauses can be drafted to cover fees incurred for no post-petition fees, some types of fees, or all possible allowable fees, although just how far the latter will reach is still uncertain in the wake of *Travelers.* The California reciprocity statute must be taken into account as well.

- Sample provision intended to *exclude* bankruptcy litigation: "In the event that an attorney is employed or expenses are incurred to pursue, protect, enforce, or

litigate the obligations hereunder, whether by suit, action, or other proceeding, the undersigned promises to pay all such expenses and reasonable attorneys' fees, except for any fees or expenses incurred in or with respect to any bankruptcy proceeding."

- Sample provision intended to include *some* but not all types of bankruptcy litigation: "In the event that an attorney is employed or expenses are incurred to pursue, protect, enforce, or litigate the obligations hereunder, whether by suit, action, or other proceeding, the undersigned promises to pay all such expenses and reasonable attorneys' fees, except that in any bankruptcy proceeding, fees or expenses shall only be recoverable to the extent that they are incurred in litigating (i) an objection to a proof of claim based on obligations arising under this agreement; (ii) interpretation or enforcement of the obligations arising under this agreement; or (iii) the terms or conditions of the assumption or rejection of this agreement."

- Sample provision intended to *include* as much bankruptcy litigation as possible: "In the event that an attorney is employed or expenses are incurred to pursue, protect, enforce, or litigate the obligations hereunder, whether by suit, action, or other proceeding, the undersigned promises to pay all such expenses and reasonable attorneys' fees, including, without limitation, reasonable attorneys' fees incurred in or with respect to any bankruptcy proceeding." (See generally, *Gil, supra*, 121 Cal.App.4th at p. 744 ("[A]n attorney fee provision applicable to 'any dispute under the agreement' is sufficiently broad to include the assertion of a contractual defense to fraud and breach of fiduciary duty causes of action.").)

Of course, the foregoing sample provisions will not necessarily cover all conceivable circumstances involving the incurrence of attorneys' fees in the bankruptcy context. A creditor's position regarding the scope of the attorneys' fees provision in contract negotiations will now entail a delicate balancing act between seeking broad recovery of potential attorneys' fees while recognizing that such recovery will likely be payable in discounted "bankruptcy dollars" in the event of the debtor's bankruptcy, and the risk of the creditor being fully liable to the debtor for reciprocal attorneys' fees.

Conclusion

In *Travelers*, the Supreme Court struck down the *Fobian* rule but left unresolved the question of whether attorneys' fees, incurred in the post-petition period pursuant to a pre-petition contract, are allowable under the Bankruptcy Code. Until that question is resolved, litigation over the allowability of contractual claims for post-petition attorneys' fees is likely to give rise to conflicting decisions. Parties can help protect their interests by drafting attorneys' fees clauses that take into account both California law and the areas of remaining uncertainty in the wake of *Travelers.*